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The Case for a Rhodesian Gold Subsidy

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THE CASE FOR A RHODESIAN GOLD SUBSIDY[1]

R. S. WALKER

I wish to divide my paper into three sections. First, it is necessary to deal with the position which gold occupies in the world. Secondly, I propose to relate this world position to Rhodesia and leading on from these two considerations I then wish to explain how I think a gold subsidy could be operated in this country. I propose to consider gold as money. It is true that the industrial use of gold is on the increase throughout the world and the special properties of this metal will no doubt result in an ever increasing industrial application because of its very special qualities. As modern industrial requirements become increasingly precise and sophisticated the indestructibility, malleability and high conductivity of gold will become industrially ever more important even at the high price which must be paid for it. John Lock defined money as "Some useless thing that men desire but which is useless in relation to living needs." In other words Lock considered that money must be precious and ever since the beginning of time men have regarded gold as precious and desirable for itself. This in an emotional conviction rather than a rational idea but it is all the more real because it is based on emotion. In the most troubled and politically disturbed parts of the world today when ordinary people have lost confidence in almost every other means of exchange, gold retains its value and in many cases increases its value greatly. During the last war, agents parachuted into the Balkans and the Middle East were invariably supplied with gold and this was accepted for its value by friend and enemy alike.

A more modern definition of money than that which I have quoted from John Lock, is the definition of currency and promissory documents which are immediately negotiable. I want to suggest to you that money can be divided into two broad sections. Firstly, there is money which has value in itself. For example, the only money which we have in Rhodesia with anything like a real worth approaching its value is the penny which is equivalent to copper valued at approximately £650 per long ton. During the last few years copper has, on occasion, reached this price. There is, however, little money in circulation throughout the world today which has a value in itself. This form of money can be termed old fashioned money or, as I would put it "value money." The other type of money which is much more modern has been called by Dr. J. E. Holloway, the noted South African economist,

1. *Paper read to the Society in July, 1967.*

"authoritarian money." Authoritarian money depends for its value on the authority standing behind it. For example, the value of a Rhodesian pound note depends on the Government and banking machinery which operates in order to ensure that 20/– worth of goods or services may be obtained for a one pound note. At this point it is necessary to differentiate between credit and authoritarian money. Personally I incline to the view that all our money today is merely credit and that a one pound note which is a promise to pay on demand is just as much credit as an agreement to provide finance in six months' time. However, modern convention inclines to the view that only credit documents or balances which can be negotiated immediately should be classified as money.

Responsibility of Governments

It must be recognised that since governments have taken on responsibility for the economic health of the countries which they govern they have been forced to use credit control mechanisms in order to carry out this responsibility. For example, a government operating through its central bank and through its commercial banking system has only two main considerations when deciding how much or how little credit it will allow to become available in the country which it governs: and, as I have already said, our currency in circulation is merely an extension of the credit availability which the government is prepared to allow. Even when the private financial sector of a country has insufficient confidence to make available credit in the normal way it is still open for a government through heavy government spending and various other methods to pump purchasing power into a community.

The two considerations which I have just mentioned are, firstly, the danger of inflation within a country through the creation of excess credit. This is to say that if there is too much credit created and therefore too much purchasing power in relation to goods and services available, the value of the monetary term in which the credit is expressed is bound to fall and one pound's worth of credit or purchasing power buys an ever decreasing amount of goods and services because the goods and services which the public wishes to acquire are just not available. There are fairly accurate methods of measuring inflation in a modern economy and so this aspect can be watched by the powers that be. The second consideration is the question of the country's financial relationship with the outside world and whether it has sufficient exports to pay for the imports which it wishes to buy. This consideration can be controlled by the instruments of currency control, import control and, to a certain extent, export control; despite the sacrifice which has to be made to these controls in the flow of development capital and loan capital of various kinds between countries. This has particular reference with regard to the economic assistance which the less developed countries of the world nowadays expect to attract from the more highly developed financial systems of the richer and more complicated countries. It is to this second consideration which I wish to relate the role of gold.

I have already explained that in the world today, most money is authoritarian money which depends on a political organisation such as a government for its value. International money, that is the money which is used for the settlement of debts between countries cannot be considered as authoritarian money unless there is an international political system to ensure its value. The United Nations seems to lack the power or ability to fulfil this role and therefore international money has to be considered as a money of mutual confidence between countries or to go back to the old fashioned kind of money as value money. I should therefore like to divide international money into confidence money and value money.

International Liquidity

During the last five or six years, the world has become increasingly concerned with an alleged lack of international liquidity. In other words, with the ever increasing volume of international trade and the ever decreasing lack of confidence between countries, the money available for settling international debts had fallen substantially below that required to carry on world trade. The most financially powerful nations of the world belong to an organisation known as the Group of Ten, and these countries have been discussing this question of international liquidity with greater and greater concern during the last years and even months.

After the last war, an international agreement was reached at Bretton Woods which stipulated that the American dollar and British sterling should become the main currencies for international trade. It was accepted that these two currencies and, in fact, all other currencies belonging to countries who eventually joined the International Monetary Fund should be pegged to gold at a value of $35 per fine ounce. I should like to quote two of the provisions included in the agreement setting up the International Monetary Fund. Firtsly, the par values of the currencies of members must be defined in gold or in the U.S. dollar of the weight and fineness of 1944, which is to say in gold. The other provision I would like to quote is that the fund may make uniform proportionate changes in par values that is, a rise in the price of gold for all currencies by a vote including its largest members but no country need accept a change in the price of gold in its own currency. Since Bretton Woods there has been a sharp decline in the willingness of the world as a whole to use sterling as a currency of international settlement owing to lack of confidence in the basis of sterling which is the British economy. Until the last few years, the American dollar did not suffer from this lack of confidence. However, a continuing balance of payments deficit in the United States economy has now resulted in a fall of confidence in the dollar. I do not think this fall of confidence is material as the great strength of the American economy allows the United States to claim with considerable justification that she is the banker of the world. However, the last few years has seen the French reluctance to hold dollar balances and this same reluctance has been demonstrated to a lesser extent in other quarters. This has, of course, been amplified by the ever increasing dollar balances which many countries hold as part of their national reserves. As a result there have been a casting around for some alternative. The most obvious alternative is international money of last resort which must be "value money" rather than confidence money and the only "value money" available internationally is gold or direct trade barter. This latter system is extremely complicated and unwieldy in operation and for the purpose of my argument is of no significance. Gold therefore has been increasingly considered as the most reliable method of settling international debts. There is, however, insufficient gold to fill the gap.

The U.S. as World Banker?

Much international thought has been given towards the creation of so-called paper gold or else a new form of international credit unit to replace the dollar and sterling. A substantial volume of economic thought in America and elsewhere considers that as America can rightly be considered as the banker of the world, she should then be entitled to use normal banking practice and apply the old principle of banking within a settled country that all demand deposits will never be drawn out at one time and therefore it is unnecessary to maintain reserves to meet a total run on the bank. It seems unthinkable that all the countries holding dollar balances at present should together wish to see these dollar balances immediately translated into goods and services from the United States. There is considerable strength in this argument but the whole difficulty as I see it, is the question of proportion and the question of guessing how great the volume of countries who wish to liquidate their dollar balances is likely to be at any given time. Nobody can tell this as it depends on international politics, on war and peace, and on the general world balance of power.

In my opinion this view of America as the world's banker goes completely contrary to the basic requirement of confidence money or authoritarian money in that it must have a completely reliable political machine behind it with the power to enforce its value. Even the United States does not have that power in the world today. If this analysis is extended to the proposed role to be played by paper gold or other forms of international reserve units the weakness is even more apparent. There have been several other devices used with considerable success during recent years, such as swop credits and Euro-dollars which are both agreements between countries to settle their outstandings more easily by mutual book entries.

All these devices only postpone the day when the increasing demand for international value money is bound to cause an economic crisis of great proportions. In simpler terms an international lack of mutual confidence which is the stuff out of which all depressions are made. In the modern world we should be very grateful that economic measurement techniques are sufficiently reliable to predict impending financial crises and to give some hope of remedial action being taken in advance. The remedial action which is gathering more support every day is an increase in the price of gold throughout the entire world as was envisaged in one of the provisions devised at Bretton Woods which I mentioned earlier in this paper.

A Rise in the World Gold Price?

Gold has been valued since 1934 at 35 U.S. dollars per ounce. It has been maintained at this value by a very simple device in that the United States has been prepared to buy or sell gold within a few points of this price. It is unnecessary to explain that any commodity can be kept at a completely stable price provided one organisation has sufficiently selling and buying capacity to be prepared to buy and sell at a fixed price. The American economy is sufficiently large to do this.

I would like to examine in greater detail the predicament for America which gold shortage provides. During recent years private and national hoarding of gold has become almost a dominant feature in the world's finances. To illustrate this I should like to quote the following figures:

Calendar Year	Free World Production	Russian Sales	Supply of Gold	Total to Private Use	Addition to Monetary Stocks
1962	37.7	6.0	43.7	—34.7	9.0
1963	39.2*	16.0	55.2	—31.2	24.0
1964	40.6*	13.0	53.6	—32.6	21.0
1965	41.7*	16.0	57.7	—45.7	12.0
1966	41.7*	—	41.7*	—41.7*	Nil

* Estimated or Provisional figure

Thus, during 1966, it has been estimated that the total production of new gold went to hoarding. There was thus no new gold available for the normal purpose of international money. If you add to this the fact that all holders of dollar balances consider themselves as entitled to payment in gold as a payment of last resort, the situation for America becomes really serious. As I have mentioned earlier, the French have been converting dollars into gold for some time and the Chinese convert all their American dollar balances into gold as quickly as possible.

Now consider America's position. At present her short term liabilities amount to approximately 26 billion dollars plus 5 billion dollars which she owes to international organisations thus making 31 billion dollars in all. At present America holds approximately 13 billion dollars in gold and, in addition, has a deficit in her balance of payments position which at present there appears to be little hope of correcting. If we are to accept that America is the world's banker, this is quite a comfortable position banking wise provided that there is no run on the bank; that is, given world stability. France, for example, has only drawn between 1 and 2 billion dollars during her recent gold buying campaign. However, America's gold reserves continue to fall in actual fact and more so in ratio to her commitments. Washington is thought to regard the safety limit for American gold as 10 billion dollars. At this point I would like to remark on recent announcements made by the two largest banks in America.

> "The Chase Manahattan Bank mentioned the well-known fact that, as the total liquid liabilities of U.S. banks to foreigners is over two times the amount of the U.S. gold stock, a run on that stock could not possibly be satisfied. To that they added the following: 'If it is made unmistakably clear that in the event of a crisis the U.S. would simply terminate the privilege now given to foreign central banks of buying gold freely, then the burden of decision regarding the defence of the dollar would be shifted even more than now from the U.S. to the shoulders of European and other Central Banks'. The words and the meaning are clear, but it is difficult to believe that an American bank could have seen fit to publish them.
>
> Shortly afterwards the President of the Bank of America, the largest bank in the U.S.A., said the following: 'In the event a cumulative gold drain becomes intolerable, we will have no choice but to react with more massive retaliatory measures. These measures, which will inevitably include the abandonment of our gold selling policy, it must be made clear, are the efforts of last resort, to be taken only when it is abundantly evident that other major countries are not prepared to function under the only feasible international monetary system—that is to say the dollar standard'."

Now what can America do? If she increases the price of gold she virtually defaults in the eyes of her creditors because they agreed to hold American dollars believing these to be worth 35 dollars to one ounce. If America does not increase the price of gold she continues to weaken the dollar at least in the eyes of much of the world. If she agrees to stop selling gold at $35 an ounce the price of gold will increase rapidly throughout the rest of the world through shortage of supply. This could be a way of rectifying America's difficulties without having to take the positive step of re-valuing gold herself but it would smack of somewhat sharp practice. Thus the only thing left for America to do, as most of her economic thinking sees it at present, is to attempt to persuade the rest of the world to accept more and more paper credit in place of gold. As I have already said, international credit requires international authority to become money and where is the international authority to give this credit value and thus turn it into real money?

In my view and within a few years America will be forced to pressurise the rest of the world into following one of the solutions set out at Bretton Woods, that is, a general increase in the value of gold carried out by all the major currencies of the world at the same time. Such an increase would have little significance unless the price of gold was doubled to $70 dollars per ounce. This measure of re-valuing gold while essential in the near future is not one which should be repeated any more frequently than can be avoided. Thus there is every argument for a substantial increase when an increase in price has to be made.

The argument that the only countries which would really benefit from an increase in the price of gold are South Africa and Russia is fallacious. It would be 14 years before South Africa achieved the advantage of re-valuing gold which America would get through the stock of gold which she at present holds. In fact, as far as South Africa is concerned an increase in the price of gold at present would only add to the inflationary pressures which the South African government is using every endeavour to suppress. Russia might be helped in the short run in that she would receive a greater volume of western goods for her gold output, but this in turn would surely ally the Russian system closer and closer to the western system: a highly desirable political objective in the world of today.

The Group of Ten are at present considering all kinds of new credit and international currency unit systems. I can see no satisfactory answer except an increase in the price of gold and from reading the speeches and thinking of world economists there is an ever increasing proportion who are coming round to this view.

The Position in Rodesia

Now I want to consider the position in Rhodesia. During 1965, Rhodesia produced between 500,000 and 600.000 ounces of gold. She is a very small country by world standards as a gold producer. Rhodesia has no necessity for gold to back her currency as exchange control and import control enable the Rhodesian government to dictate the value of the Rhodesian pound in terms of the hard currencies of the world. Rhodesia uses Rhodesian currency inside Rhodesia and other people's currency outside Rhodesia. Thus within the country she uses a complete authoritarian system of money while outside she uses money attached to the authoritarianism of other countries .Thus I want to stress again that internally Rhodesia has no necessity for gold to back her currency and while other countries are prepared to allow Rhodesia to deal in their currencies she does not require gold for her external transactions, but suppose things became more difficult.

Gold has two tremendous advantages, firstly, it is value money which anybody will accept anywhere. Secondly, it can be transferred into goods and services at a very low selling cost. It has, of course, the disadvantage that unlike balances held in foreign currencies it earns no interest.

When a man loses confidence in his bank he hides his savings under the bed in an old sock. This is also how one must perhaps retain some reserves during an economic war.

Normally it is sound economics to avoid subsidising production of any given commodity as this must in the end encourage inefficiency and inflation. However, under Rhodesia's present circumstances with a closed economy and lack of full employment the country can create credit at will right up to the point of inflation. This is a system we can use to finance tobacco stockpiling. Now just suppose our stockpiled tobacco was gold, what a wonderful reserve of puchasing power internationally speaking this would be and if we can stockpile tobacco on the basis of what may be subsidised prices, then how much more to our advantage it would be to stockpile gold. Surely if we have to accept the restrictions and lack of economic freedom which our present circumstances demand and the continuation of a managed economy we should also be able to obtain some of the advantages and stockpile subsidised gold.

The question arises of how this is to be done. One of the provisos of the Bretton Woods agreement, was that no member of the International Monetary Fund may buy or sell gold at a price above or below par value plus or minus the margin prescribed by the Fund. This is at present 1%. Although it is questionable whether Rhodesia still remains a member of the International Monetary Fund, there is a strong argument in favour of maintaining our financial integrity completely unimpaired so that the rest of the world may say we don't like your politics but we trust your economics.

Several countries have found ways round this difficulty. There are gold subsidy arrangements in Canada and Australia together with several other countries. We in this country have the gold assistance legislation which allows a mine to be assisted up to the maximum extent of £3 per ounce in certain circumstances and provided that no profit is made.

We are a small enough producer of gold in this country for each individual mining enterprise to be considered on its individual merits and to be provided with the necessary incentive to produce more gold. This incentive must include an element of profit because in our type of economy the profit motive is of the essence and men will only give of their best when the carrot of profit enters into their thinking at least to a limited extent. This is nothing to be ashamed of.

In our present circumstances it is not necessary to balance our national budget on both revenue and capital account although I think it advisable to balance the budget on revenue account. Savings can always be used either for development or for stockpiling in any circumstances. In fact one must maintain a judicious mixture of both. It is unfortunate that in the system of government accounting which we have inherited from Great Britain we only consider the payments and the receipts and never the value of the accumulations. The picture of the housewife who always spends her money in buying new mechanical aids while maintaining an empty store cupboard is all too familiar in this country.

There is one aspect of gold mining on which I wish to touch briefly. It is wrong to believe that gold which is not mined today can be mined tomorrow. The cost of extracting gold ore from the ground depends on the means of access available. When shaft systems are abandoned, allowed to fill with water and decay, the cost of going back again to recover ore which was previously unpayable has become prohibitive even with a rise in the value of gold. If we do not provide means by which our gold mining industry can extract the gold available to it today, this gold will not be available to us tomorrow.

Conclusions

I have tried to show that I believe there will be an increase in the price of gold within the next few years. Secondly, I have tried to explain how important a greater production of gold and a stockpile of gold can be for Rhodesia during an economic war even if there is no increase in the price of gold. We are a small country, smaller financially than some of the great businesses of the world. If we regard ourselves as a large business enterprise rather than a country there is, for the reasons I have already given, an overwhelming justification for increasing our output of gold now through artificial financial means. If this is true when Rhodesia is considered as a business, then it is certainly true when Rhodesia is considered as a country.

The necessary legislation is available to us and requires only modest amendment. Our managed economy makes the provision of credit possible without damaging the economy of the country. At worst we shall reap the benefit of greater reserves with which to fight an economic war. At best we shall secure the major advantage of an increase in the price of gold and the ability to buy twice as many goods and services from abroad for one ounce of gold as we can secure at present.

Salisbury.